

Message Text

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ACTION EUR-12

INFO OCT-01 EA-10 ISO-00 AID-05 CIAE-00 COME-00 EB-08

FRB-03 INR-07 NSAE-00 USIA-06 XMB-02 OPIC-03

SP-02 LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-04

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R 091620Z SEP 77

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TO SECSTATE WASHDC 7063

DEPT OF TREAS WASHDC

INFO AMEMBASSY BERN

AMEMBASSY BONN

AMEMBASSY BRUSSELS

AMEMBASSY THE HAGUE

AMEMBASSY LONDON

AMEMBASSY PARIS

AMEMBASSY TOKYO

AMCONSUL MILAN

AMCONSUL NAPLES

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ALSO FOR USEC BRUSSELS, USOECD PARIS; PASS FRB

E.O. 11652: N/A

TAGS: EFIN, IT

SUBJECT: ITALIAN FINANCIAL MARKET DEVELOPMENTS (77-4)

REF: A. ROME 14338, B. ROME 13989, C. ROME 12762

1. ACCORDING TO LATEST AVAILABLE DATA ON ITALIAN INTERNATIONAL MONETARY TRANSACTIONS (TABLE 1), ITALY'S OVERALL BALANCE OF PAYMENTS, WHICH MOVED INTO SURPLUS IN JUNE (REF C), CONTINUED IN SURPLUS IN JULY AND THE FIRST HALF OF AUGUST. THE CUMULATIVE OVERALL BALANCE OF PAYMENTS

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DEFICIT FOR THE PERIOD JANUARY 1 - AUGUST 15 IS \$290 MILLION, COMPARED TO A CUMULATIVE DEFICIT FOR THE YEAR TO THE END OF MAY OF \$2.4 BILLION. AN IMPORTANT FEATURE OF RECENT BALANCE OF PAYMENTS DEVELOPMENTS HAS BEEN CESSATION OF BUILDUP OF BANKS' NET FOREIGN LIABILITIES IN THE SECOND HALF OF JULY AND THE REDUCTION BY \$263 MILLION OF THE BANKS' NET FOREIGN DEBTOR POSITION DURING THE FIRST

HALF OF AUGUST. IN ADDITION, DURING THE PERIOD JULY 1 - AUGUST 15, ITALY REPAID (828.5 MILLION TO THE IMF (THE FIRST AND SECOND TRANCHES OF ITS 1974 STANDBY), AS SHOWN IN TABLE 3, WHILE OFFICIAL FOREIGN EXCHANGE HOLDINGS INCREASED BY \$791 MILLION (TABLE 1). SINCE THEN ITALY REPAID \$500 MILLION ON THE BUNDESBANK GOLD LOAN ON SEPTEMBER 5, WHICH REDUCES THE AMOUNT OUTSTANDING ON THIS LOAN TO \$1.5 BILLION.

2. NO DATA ARE YET AVAILABLE ON "ABOVE THE LINE" DEVELOPMENTS IN THE BALANCE OF PAYMENTS SINCE END JUNE. (THE MOST RECENT TRADE DATA ARE FOR JUNE, REF:.) IT IS NOT POSSIBLE TO SAY WITH CERTAINTY, THEREFORE, TO WHAT EXTENT THE FAVORABLE DEVELOPMENTS "BELOW THE LINE" ARE DUE TO POSITIVE TRENDS IN THE CURRENT ACCOUNT OR TO NEW INFLOWS OF OTHER FORMS OF CAPITAL, BUT EMBASSY BELIEVES ON THE BASIS OF AVAILABLE INFORMATION ON TRADE AND TOURISM THAT THE IMPROVEMENT IN ITALY'S OVERALL BALANCE OF PAYMENTS SHOULD BE ATTRIBUTED MOSTLY TO THESE ACCOUNTS.

3. ON AUGUST 26 THE BANK OF ITALY REDUCED THE DISCOUNT RATE TO 11.5 FROM 13 PERCENT (REF B). INTERBANK RATES HAVE SINCE DECLINED BY ABOUT 1 TO 1 1/2 PERCENTAGE POINTS TO ABOUT 12.5 PERCENT, AND BANKS REDUCED THE PRIME RATE TO 17 FROM 18.5 PERCENT (REF A). INTERBANK RATES AND TREASURY BILL YIELDS, WHICH ARE THE MOST IMPORTANT FACTORS IN DETERMINING THE RETURN ON SAVINGS, HAVE COME DOWN LIMITED OFFICIAL USE

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ALMOST CONTINUOUSLY FROM THEIR MARCH HIGHS OF ABOUT 17 PERCENT, APPROXIMATELY IN LINE WITH THE DROP IN THE INFLATION RATE (AND PRESUMABLY INFLATIONARY EXPECTATIONS). MONTH OVER MONTH PERCENTAGE CHANGES IN THE COST OF LIVING SINCE FEBRUARY ARE AS FOLLOWS: 2.3 IN FEBRUARY, 1.5 IN MARCH, 1.1 IN APRIL, 1.3 IN MAY, 0.9 IN JUNE AND 0.8 IN JULY. CURRENTLY THE RATE OF INFLATION APPEARS TO BE ABOUT 11 TO 12 PERCENT AT AN ANNUAL RATE.

4. ITALY'S HEAVY SHORT-TERM FOREIGN INDEBTEDNESS SHOULD BE A SIGNIFICANT LIMITING FACTOR, HOWEVER, IN HOW FAR DOMESTIC INTEREST RATES CAN COME DOWN. THE COVERED INTEREST ARBITRAGE INCENTIVE FAVORING BORROWING ABROAD, WHICH EXISTED DURING THE PERIOD OF THE RAPID BUILD-UP OF THE ITALIAN BANKS' NET FOREIGN INDEBTEDNESS, HAS TURNED AROUND, AND THERE IS NOW A DISINCENTIVE TO SUCH COVERED DOLLAR PLACEMENTS IN ITALY. THE REDUCTION DURING AUGUST 1-15 (TABLE 1 AND 2) IN THE BANKS' NET FOREIGN DEBTOR POSITION REFLECTS THE NEW RELATIVE INTEREST RATE SITUATION AS WELL AS REDUCED DEMAND FOR CREDIT BECAUSE OF THE RECENT SLOWDOWN IN INDUSTRIAL ACTIVITY. A TOO SUDDEN REVERSAL OF THE PREVIOUS SHORT-TERM CAPITAL INFLOW, HOWEVER, WOULD EXERT STRONG

DOWNWARD PRESSURE ON THE LIRA, AND THE BOI WILL SEEK TO AVOID
SUCH A DEVELOPMENT THROUGH ITS INTEREST RATE POLICY.

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5. TABLE 1 - MONETARY MOVEMENTS 1) (MILLIONS OF DOLLARS)

	JULY 1-31	AUG 1-15	JAN 1-AUG 15
1. BOI/UIC			
GOLD	-	-	714.6 1)
CONV. FOR. EX.	877.8	-97.2	3,853.5
OTHER (INCL.GOLD			
REVALUATION			
LIABILITY)	311.0	447.4	-734.7
TOTAL BOI/UIC	1,188.8	350.2	3,833.4
2. COM. BANKS' NET			
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FOREIGN POSITION	-164.6	263.2	-4,132.6
SUB-TOTAL	1,024.2	613.4	-299.2
3. FOR. EX. ADJ.	6.2	-13.4	9.2
4. BOP SURPLUS/DEFICIT	1,030.0	600.0	-290.0

1) INCLUDES GOLD REVALUATION OF \$706. EQUAL CONTINGENT
LIABILITY INCLUDED IN "OTHER."

6. TABLE 2 - FOREIGN RESERVE POSITION (MILLIONS OF DOLLARS).

	DEC 31, 1976	JULY 31, 1977	AUG 15, 1977
1. BOI/UIC			
GOLD	9,320.5	10,035.1	10,035.1
CONV. FOR. EX.	3,132.0	7,082.7	6,985.5
OTHER (INCL. GOLD REVALUATION)1)	-12,372.0	-13,554.1	-13,106.7
TOTAL BOI/UIC	80.5	3,563.7	3,913.9
2. COMM. BANKS' NET			
FOR. POSITION	-3,011.0	-7,406.8	-7,143.6
TOTAL	-2,930.5	-3,843.1	-3,229.7

1) INCLUDES LIABILITIES TO EC, BUNDESBANK, AND IMF.

7. TABLE 3 - EXTRAORDINARY TRANSACTIONS (MILLIONS OF DOLLARS).

	JULY 1-30	AUG 1-15	JAN 1-AUG 15
FIAT/LIBYA	-	-	306.0
IMF (1974) STANDBY	-456.6	-371.9	-828.5
IMF (1977) STANDBY	-	-	104.0
BUNDESBANK LOAN	-	-	264.0
EC LOAN	-	-	500.0
GOLD REVALUATIONS	-	-	705.9
EUROMARKET LOANS	-	-	-200.0

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8. TABLE 4 - FINANCIAL MARKET RATES

	JULY 29	AUG 31	SEPT 7
LIRA/\$ SPOT RATE	881.6	882	882.2
LIRA/\$ FORWARD 6 MO.	926.1	127.0	922.7
BLACK MARKET-	881	880	878
LIRA/\$ 3 MO. FORWARD			
DISCOUNT (PERCENT)	2.6	2.5	2.3

BOI FX INDEX 1):

ALL CURRENCIES	37.80	37.48	37.49
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DOLLAR	34.34	34.13	34.14
INTER-BANK RATES			
48-HOUR	13.37	12.37	12.12
30 MONTH	14.12	12.94	12.69

1) WEIGHTED AVERAGE PERCENT DEPRECIATION SINCE 2/9/73
(SECOND DOLLAR DEVALUATION).

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